4. Inflation

Inflation has declined further in year-ended terms but it remains high and underlying measures were stronger than expected in the September quarter. Services inflation remains very high, reflecting an environment of elevated domestic cost pressures and still-robust levels of demand. Goods inflation has declined substantially since last year as global supply chains improved and inflation in raw materials prices declined, though it is still above average levels. Price changes for a number of volatile components and administered items affected headline inflation in the September quarter; overall, however, their effects were roughly offsetting. Measures of inflation expectations have increased recently but remain consistent with achieving the inflation target over time.

Wages growth remains robust, underpinned by the ongoing tightness of the labour market and high inflation outcomes. Timely indicators suggest that wages growth increased a little in the September quarter, with the effect of the Fair Work Commission (FWC) decision partially offset by some moderation in growth in other wages. Annual growth in unit labour costs – which is the measure of labour costs that matters most for inflation – reached over 7 per cent recently, which is around its strongest pace in several decades (excluding the volatile pandemic period). This reflects the combination of robust wages growth and poor productivity outcomes; while it is difficult to assess underlying trends in measured productivity, it has declined recently to suggest little growth over the past several years.

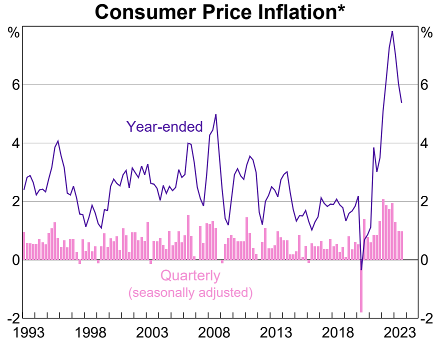
Underlying inflation was stronger than expected

The Consumer Price Index (CPI) increased by 1 per cent in the September quarter (in seasonally adjusted terms) and by 5.4 per cent over the year. This headline result was broadly as expected three months ago, and is below its peak of 7.8 per cent over the year to the December quarter of 2022 (Graph 4.1; Table 4.1).

Measures of underlying inflation (which remove the effect of irregular or temporary price changes) also eased further over the year, but by less than had been forecast three months ago, as services inflation remained high amid strong domestic cost pressures and still-robust aggregate demand. Trimmed mean inflation was 1.2 per cent in the September quarter and 5.2 per cent over the year – an increase in the quarterly rate of inflation from 1 per cent in the June quarter, but well below the peak of 6.9 per cent over the year to the December quarter of 2022 (Graph 4.2; Table 4.1).

Graph 4.1

Consumer Price Inflation*



* Excludes interest charges prior to the September quarter of 1998; adjusted for the tax changes of 1999–2000.

Sources: ABS; RBA.

Table 4.1: Measures of Consumer Price Inflation

Per cent

	Quarterly(a)		Year-ended(b)	
	September quarter 2023	June quarter 2023	September quarter 2023	June quarter 2023
Consumer Price Index	1.2	0.8	5.4	6.0
Seasonally adjusted CPI	1.0	1.0	–	–
– Tradables	0.4	0.8	3.7	4.4
– Tradables (excl. volatile items)(c)	−0.2	1.0	4.1	5.8
– Non-tradables	1.3	1.1	6.2	6.9
Selected underlying measures				
Trimmed mean	1.2	1.0	5.2	5.9
Weighted median	1.3	1.0	5.2	5.4
CPI excl. volatile items(c)	0.8	1.0	5.5	6.5

(a) Except for the headline CPI, quarterly changes are based on seasonally adjusted data; those not published by the ABS are calculated by the RBA using seasonal factors published by the ABS.

(b) Year-ended changes are based on non-seasonally adjusted data, except for the trimmed mean and weighted median.

(c) Volatile items are fruit, vegetables and automotive fuel.

Sources: ABS; RBA.

High inflation remains broadly based

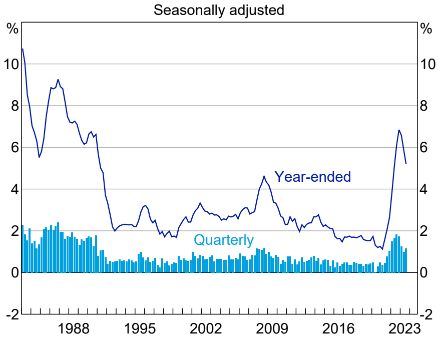
A wide range of items have contributed to inflationary pressures over the past year (Graph 4.3). Services inflation, including rents, has increased in recent quarters and is now contributing to a large proportion of inflation overall. The contributions from goods categories such as consumer durables, groceries and new dwellings have declined but remain above pre-pandemic levels.

The share of CPI categories with prices growing faster than 3 per cent remained around

Graph 4.2

Trimmed Mean Inflation*

Seasonally adjusted



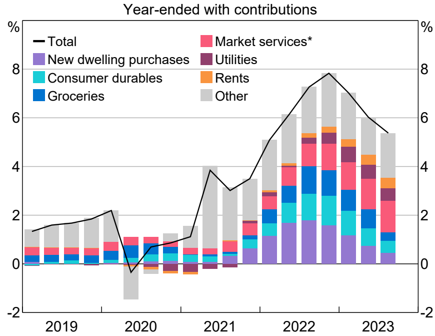
* Excludes interest charges prior to the September quarter of 1998 and deposit & loan facilities; adjusted for the tax changes of 1999–2000.

Sources: ABS; RBA.

Graph 4.3

CPI Inflation

Year-ended with contributions



* Excludes domestic holiday travel & accommodation and telecommunications.

Sources: ABS; RBA.

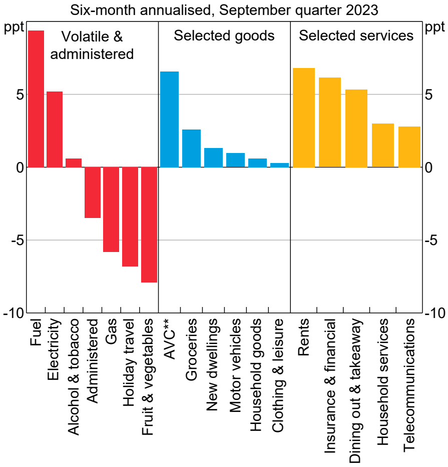
60 per cent in the September quarter. Although this share has declined from a peak of around 80 per cent last year, it is still around the top end of the range seen in the three decades prior to the pandemic. Recently, inflation rates for most categories of goods and services have been above their average over that period (Graph 4.4).

Among items that tend to have prices that are volatile or influenced by changes in government policies, recent inflation outcomes have been mixed. Government electricity rebates, increased child care subsidies and some other changes in government policies subtracted around ½ percentage point from headline inflation in the September quarter. Together with sharp falls in fruit and vegetables prices, this largely offset higher fuel and retail electricity price increases (excluding the effect of energy rebates). Fuel prices have declined over the past month to be slightly above their September quarter average (Graph 4.5).

Graph 4.4

Inflation Deviation from Average*

Six-month annualised, September quarter 2023



* Average from 1993 to December quarter of 2019; volatile & administered items are 37 per cent of the CPI basket, selected goods are 32 per cent and selected services are 26 per cent; administered excludes utilities; groceries excludes fruit & vegetables.

** Audio, visual & computing equipment.

Sources: ABS; RBA.

Services inflation was very high, reflecting an environment of elevated domestic cost pressures and still-robust demand

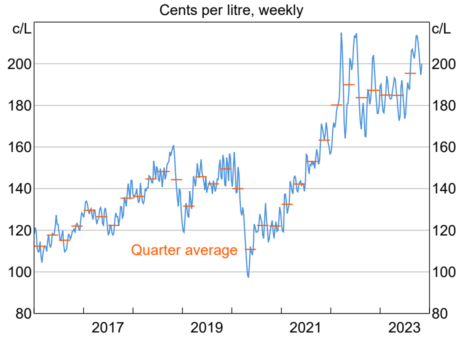
Market services price inflation (excluding domestic travel and accommodation, and telecommunications) was stronger than expected; it was 1.7 per cent in the September quarter and 7 per cent over the year (Graph 4.6). The prices of these services, which cover around one-fifth of the CPI basket, are among the most sensitive to domestically generated inflationary pressures. High inflation in this category reflects the still-robust level of demand and continued pressure from input costs (both labour and domestic non-labour). Unit labour costs – that is, the cost of labour required for the production of a given amount of output – represent a large share of input costs for market services firms and have grown strongly of late, as discussed below. Firms in the Bank's liaison program continue to report large increases in their energy costs where contracts have been renewed. Many firms report that retail rents have risen and are adding to cost pressures. Firms are also facing high inflation in the cost of inputs such as insurance, legal, accounting and administrative services.

Within market services, prices for meals out and takeaway rose by 2.1 per cent in the September quarter (Graph 4.7). Prices of household services

Graph 4.5

Automotive Fuel Prices*

Cents per litre, weekly

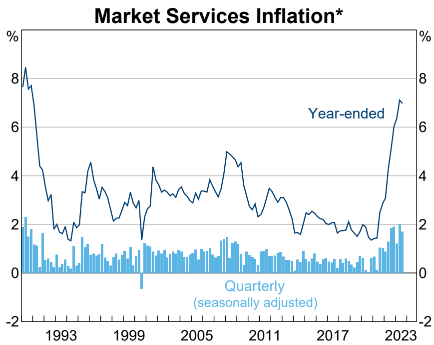


* Weighted average of unleaded and diesel fuel.

Sources: Australian Institute of Petroleum; RBA.

also increased strongly, driven by increases in prices for sports and leisure services. Insurance premiums have continued to increase significantly, reflecting higher expected claims (due to the effects of high inflation and weather events) and a reassessment of risk more broadly. Inflation in other financial services declined in the quarter due to increases in stamp duty concessions by some state governments, which lower measured prices. Prices for both domestic and overseas travel and accommodation declined in the quarter, unwinding some of the large increases recorded following the reopening of the economy.

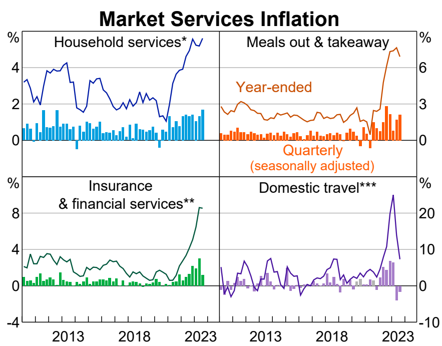
Graph 4.6



* Excludes domestic holiday travel & accommodation and telecommunications; adjusted for the tax changes of 1999–2000.

Sources: ABS; RBA.

Graph 4.7



* Includes home cleaning, vehicle repairs, hairdressing, veterinary services, sports and leisure services.

** Excludes deposit & loans to June quarter of 2011.

*** Imputed using headline CPI in the June and September quarters of 2020 and September quarter of 2021.

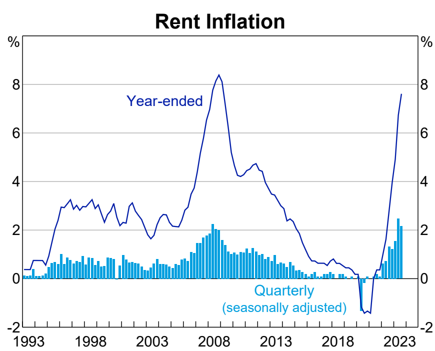
Sources: ABS; RBA.

Rents increased by 2.2 per cent in the September quarter (Graph 4.8). Excluding the effects of an increase in Commonwealth Rent Assistance in the quarter, rent inflation remained at an annualised rate of around 10 per cent, as was the case in the June quarter. High rent inflation has been broadly based, consistent with tight rental market conditions across the country (Graph 4.9). Housing supply has not kept pace with the increased demand for housing – the result of a decrease in average household size since the beginning of the pandemic, robust nominal income growth and the increase in population growth. Advertised rents have increased 30 per cent since prior to the pandemic, much more than the increase in CPI rents so far. Together with historically low vacancy rates, and little sign that tight rental market conditions will ease in the near term, this is expected to keep rent inflation elevated for some time. (For further discussion of housing, see Chapter 2: Domestic Economic Conditions.)

Goods price inflation declined further because global supply chains have improved and raw materials inflation has declined

Goods price inflation eased further in the September quarter for both consumer durables and groceries (Graph 4.10). This is because of a moderation in demand for some goods and an

Graph 4.8



Sources: ABS; RBA.

easing in inflation in the prices of imported consumption goods – despite some depreciation of the exchange rate – as global supply chain issues have improved and raw materials price inflation has declined over 2023. Shipping costs have fallen sharply this year, following a period of extremely rapid growth. Domestic labour and non-labour costs continue to place some offsetting upward pressure on final goods prices. As with firms in the services sector, firms selling goods have faced increased costs of electricity, services inputs and retail rents. Rents for industrial properties have risen particularly sharply, especially for warehouses and logistics centres.

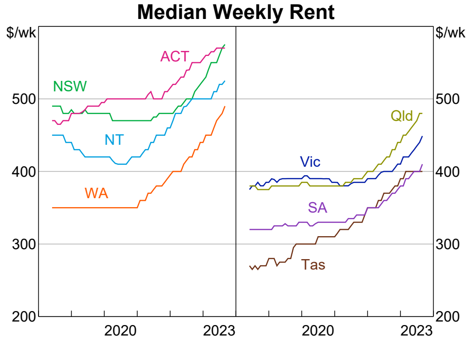
Consumer durables inflation moderated further in the September quarter to be around 3 per cent over the year – well below the peak of 7 per cent over the year to the December quarter of 2022. This reflects the easing in prices of some imported goods and some moderation in demand as consumers limit their discretionary spending due to cost-of-living pressures and more restrictive monetary policy. Prices declined in the September quarter for household appliances, furnishings, and audio, visual and computing equipment but this was offset by small price increases for clothing and motor vehicles (Graph 4.11).

Grocery prices (excluding fruit and vegetables) increased by 0.6 per cent in the September quarter – the slowest quarterly increase since mid-2021. In year-ended terms, grocery prices were 6½ per cent higher (down from 11 per cent over the year to December 2022). The easing in inflation was broadly based across grocery items, including for items with a higher degree of processing for which inflation had remained high in the prior quarter (such as bread and cereal products and other packaged food) (Graph 4.12). An exception was dairy prices, which increased by a further 2 per cent in the quarter, reflecting concerns about a structural shortage of milk produced domestically.

New dwelling cost inflation was 1.3 per cent in the September quarter, having eased dramatically since mid-2022. This is due to

Graph 4.9

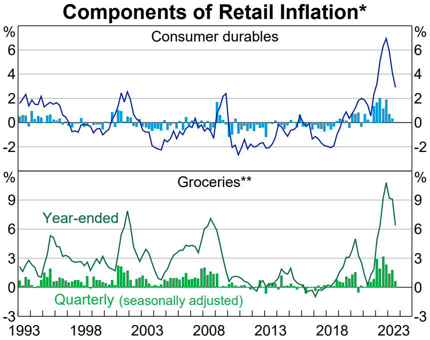
Median Weekly Rent



Source: ABS.

Graph 4.10

Components of Retail Inflation*



* Adjusted for the tax changes of 1999–2000.

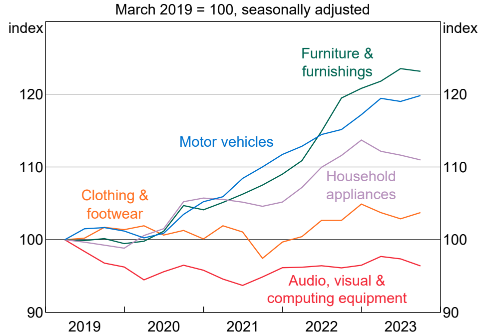
** Excludes fruit & vegetables.

Sources: ABS; RBA.

Graph 4.11

Consumer Durables Prices

March 2019 = 100, seasonally adjusted



Sources: ABS; RBA.

subdued demand for new dwellings and the easing in cost pressures for building materials (Graph 4.13). Despite this, the recent pace of new dwelling price increases remains above its inflation-targeting average. Labour shortages have remained acute at the latter stages of construction.

Electricity prices increased in the September quarter

Prices for most utilities increased in the September quarter, to be substantially higher over the past year (Graph 4.14). Electricity prices increased by 3.7 per cent in the quarter, as the pass-through of higher average wholesale costs to retail prices was in large part offset by energy rebates offered to households under the Australian Government's Energy Price Relief Plan and various state government measures. Gas prices were little changed in the quarter, following large increases over the year prior.

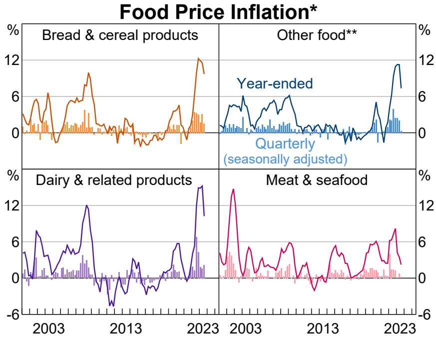
In the CPI basket, 'administered prices' are (at least partly) regulated or relate to goods and services for which the public sector is a significant provider. They include categories such as health, education and child care, as well as utilities. Administered prices (excluding utilities) were little changed overall in the September quarter, as increases in a range of inflation-indexed prices were offset by a large decline in child care prices. The decline in child care prices reflected increases in Australian Government subsidies; excluding the effect of increased subsidies, child care prices increased by 6.7 per cent in the quarter (Graph 4.15).

Inflation expectations remain consistent with the inflation target

Measures of short-term expectations have declined notably from their mid-2022 peaks (Graph 4.16). Most measures of medium- and long-term expectations remain consistent with the Bank's inflation target. Long-term measures from financial markets have increased a little

Graph 4.12

Food Price Inflation*

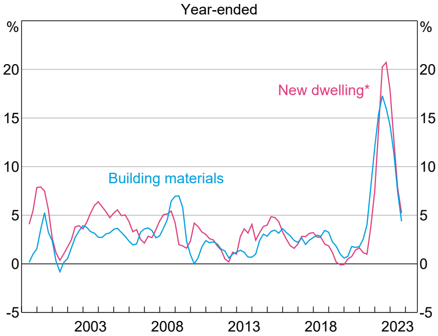


* Adjusted for the tax changes of 1999–2000.
** Includes products such as eggs, jams, oils, snacks etc.
Sources: ABS; RBA.

Graph 4.13

New Dwelling and Building Materials Inflation

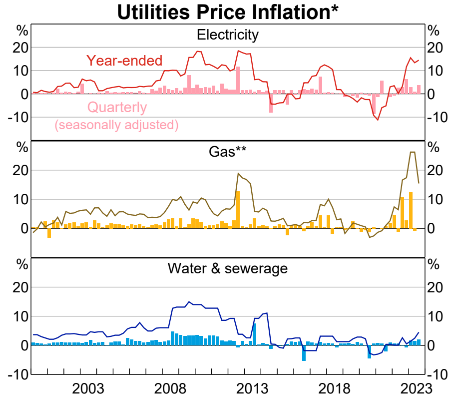
Year-ended



* Adjusted for the tax changes of 1999–2000.
Sources: ABS; RBA.

Graph 4.14

Utilities Price Inflation*



* Adjusted for the tax changes of 1999–2000.
** Includes other household fuels.
Sources: ABS; RBA.

over the past year, but remain in line with longer term averages (Graph 4.17).

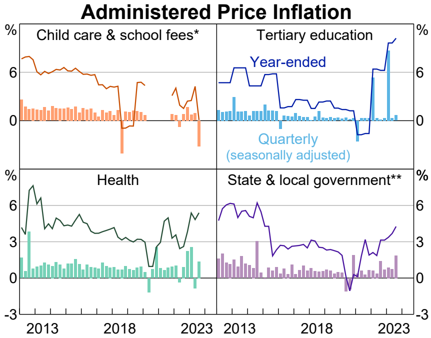
Wages growth remained robust over the year to the June quarter …

The Wage Price Index (WPI) grew by 0.8 per cent in the June quarter and 3.6 per cent in year-ended terms (Graph 4.18). Year-ended wages growth remains robust, reflecting a tight labour market, high inflation outcomes and the implementation of new public sector wage policies. Public sector wages rose by 0.7 per cent in the quarter to be 3.1 per cent higher over the year; this is the highest year-ended growth rate in a decade. Private sector wages increased by 0.8 per cent in the quarter and 3.8 per cent over the year.

The average size of wage changes (for those jobs that received a wage change in the year to the June quarter) were around decade-high levels at roughly 4 per cent in the private sector and 3 per cent in the public sector. Around one-third of wage changes were larger than 4 per cent over that period, reflecting ongoing labour market tightness and high inflation, as well as the implementation of award and minimum wage increases in the September and December quarters of 2022 (Graph 4.19). The frequency of wage changes remains above its historical average, but was a little lower in the June quarter than a year earlier, as firms reported

Graph 4.15

Administered Price Inflation



* Excludes volatile periods from June 2020 to September 2021 caused by the government's free child care policy.

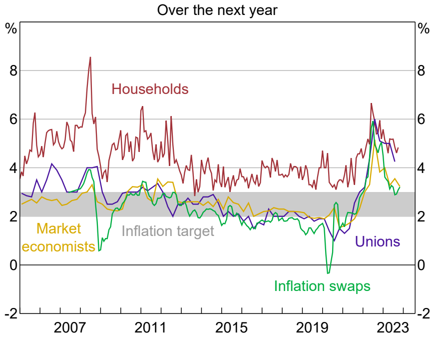
** Includes urban transport fares, property rates & charges and other services in respect of motor vehicles.

Sources: ABS; RBA.

Graph 4.16

Short-term Inflation Expectations

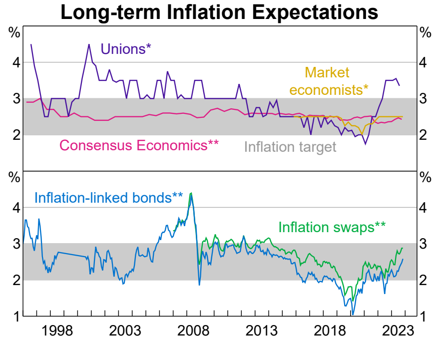
Over the next year



Sources: Australian Council of Trade Unions; Bloomberg; Melbourne Institute; RBA; Workplace Research Centre.

Graph 4.17

Long-term Inflation Expectations



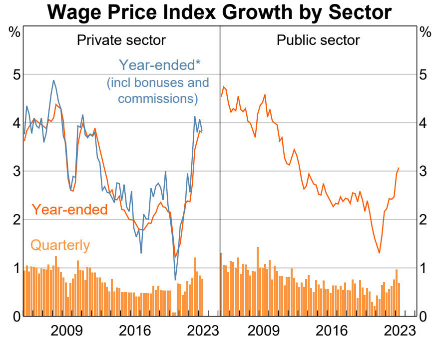
* Average over the next 5–10 years.

** Average over the five years starting from five years ahead.

Sources: Australian Council of Trade Unions; Bloomberg; Consensus Economics; RBA; Workplace Research Centre; Yieldbroker.

Graph 4.18

Wage Price Index Growth by Sector



* Non-seasonally adjusted.

Source: ABS.

making fewer ad hoc wage increases to attract or retain staff.

Wages growth for those on enterprise bargaining agreements (EBAs) has increased notably over the past year, but continues to lag behind growth in award and individual arrangement wages in year-ended terms (Graph 4.20). Much of that difference reflects the multi-year structure of EBAs, which causes a lag in the flow-through of wage pressures to agreements.

Compensation of employees – which includes the effects of wages growth as well as increases in employment hours – rose by 10 per cent over the year to the June quarter, close to the strongest rate of growth since 1990 (Graph 4.21).

While it is difficult to assess underlying trends in productivity growth over short time periods, weak productivity outcomes have contributed to rapidly rising unit labour costs. Indeed, non-farm labour productivity has declined to be around the levels recorded several years ago, as total hours worked have increased by considerably more than output. Labour productivity fell sharply in the 2022/23 financial year as a whole, reflecting a decline in the capital-to-labour ratio and multifactor productivity, which measures changes in the productivity of both labour and capital combined (Graph 4.22). The decline in labour productivity contributed to strong growth in unit labour costs of around 7 per cent in 2022/23 relative to the year prior (Graph 4.23).

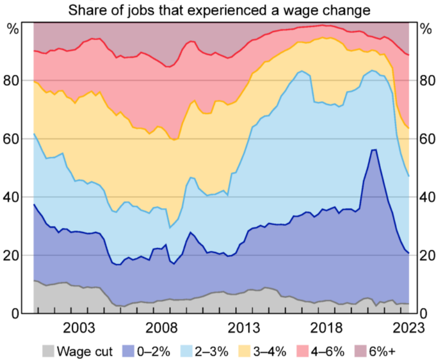
… and is expected to increase a little further in the September quarter as award wage increases have been partially offset by easing wages growth in other jobs

A range of timely indicators suggest that year-ended wages growth increased a little further in the September quarter (Graph 4.24). Increases in award and minimum wages took effect from 1 July, following the FWC's annual wage review,

Graph 4.19

Wage Changes of Different Sizes*

Share of jobs that experienced a wage change



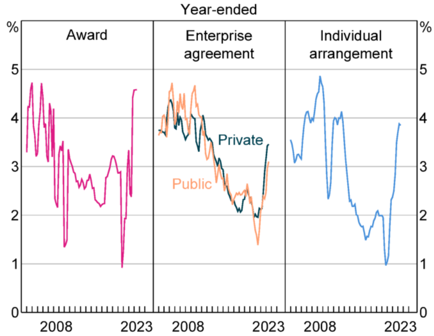
* Smoothed using a four-quarter trailing average.

Sources: ABS; RBA.

Graph 4.20

Wages Growth by Pay-setting Method*

Year-ended



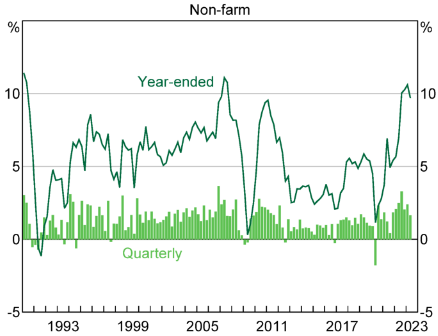
* Excludes bonuses and commissions.

Sources: ABS; RBA.

Graph 4.21

Compensation of Employees Growth

Non-farm



Source: ABS.

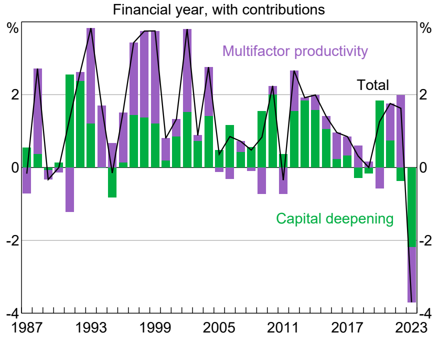
and so far there do not appear to be larger-than-normal spillovers to the wages of those on enterprise bargaining or individual wage agreements. According to liaison with firms, there has been some offset from a moderation in wages growth for other jobs, particularly in some occupations and industries (like business services and construction) where wages growth was especially strong last year. In addition, some firms have reported offsetting award wage increases by providing lower wage increases for non-award workers. Market economists and firms in the Bank's liaison program expect wages growth to be around 3½ to 4 per cent over the year ahead (Graph 4.25). Beyond that, market economists expect wages growth to ease a little to around 3¼ per cent.

Wages growth in newly lodged enterprise agreements – which provides an indication about the direction of average enterprise agreement wages growth – increased to 4 per cent in the September quarter (Graph 4.26). The range of underlying outcomes is wide and some of the larger increases reflect specific circumstances, such as wage catch-up after extended negotiation periods and agreements in the aged care sector that follow the FWC decision to raise industry award wages by 15 per cent.

Graph 4.22

Labour Productivity Growth*

Financial year, with contributions



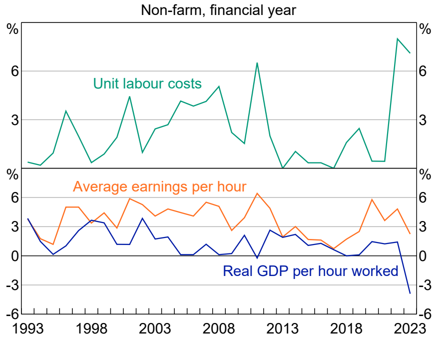
* All industries.

Sources: ABS; RBA.

Graph 4.23

Unit Labour Cost Growth

Non-farm, financial year

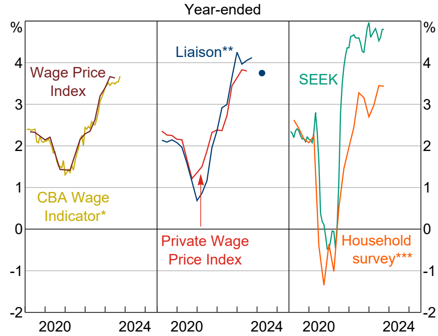


Sources: ABS; RBA.

Graph 4.24

Timely Measures of Wages Growth

Year-ended



* Changes in base wages based on a sample of CBA retail banking transactions.

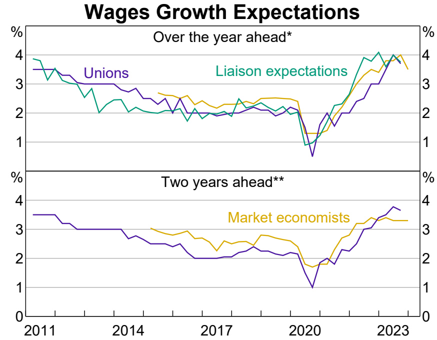
** Private sector; trimmed mean; rescaled to have the same mean as the private Wage Price Index; dot represents liaison expectations advanced two quarters.

*** Based on a 30 per cent trimmed distribution.

Sources: ABS; CBA; Melbourne Institute; RBA; SEEK.

Graph 4.25

Wages Growth Expectations



* The current calendar year for union expectations.

** The next calendar year for union expectations.

Sources: Australian Council of Trade Unions; RBA; Workplace Research Centre.

Increases to public sector wage policies and administrative decisions will support wages growth in the period ahead

Changes to wage policies in a number of jurisdictions will continue to flow through to wages growth over coming quarters. The NSW Government recently announced a four-year agreement with public school teachers, including base wage increases of between 8 per cent and 12 per cent from October this year. The Australian Government revised up its proposal for wage increases to 4 per cent in the first year of the agreement, 3.8 per cent in the second year and 3.4 per cent in the third year, although negotiations with employees are ongoing. The FWC approved an application for childcare workers to bargain for pay rises under the new multi-employer bargaining laws and the major union for the childcare industry has proposed a pay rise of 25 per cent.

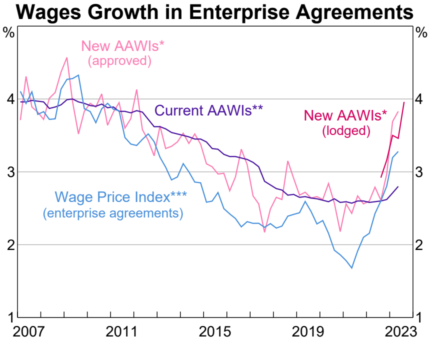
Real base wages were broadly stable in the June quarter, following declines over the past two years

Real wages (as measured by the difference between the seasonally adjusted WPI and CPI) declined by 0.1 per cent in the June quarter; this was the smallest quarterly decline since 2020, as wages growth has increased and inflation has moderated since last year. Real wages have declined by around 5 per cent over the past two years based on base wages alone. By contrast, real employment income has increased, as the fall in real base wages was more than offset by an increase in hours worked, people switching to higher paid jobs or receiving promotions, and firms offering additional payments such as overtime or cost-of-living bonuses. The rise in inflation has been broadly based across the income distribution and household types (Graph 4.27). Real wage declines have been smaller for lower wage earners because nominal wages growth has been strongest for this group, due in part to the FWC award wage decision. Administrative employment data suggests that lower income workers also experienced stronger earnings growth than higher income workers in the year to the June quarter. Across all quintiles, real employment income increased.

Growth in cost-of-living indices eased in the September quarter across most household types but remains high (Graph 4.28). The experience of individual households varies widely. Rising living costs tend to impact lower income households

Graph 4.26

Wages Growth in Enterprise Agreements



* Quantifiable average annualised wage increases (AAWIs) in new FWC-approved and federally registered enterprise agreements; dark pink line represents quarterly average of AAWIs in newly lodged agreements; data for the dark pink line is up to September quarter 2023.

** AAWIs in the total stock of nominally current, FWC-approved and federally registered enterprise agreements.

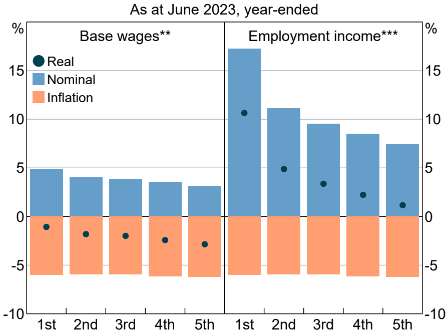
*** Year-ended growth; excludes bonuses and commissions.

Sources: ABS; Department of Employment and Workplace Relations; FWC.

Graph 4.27

Growth in Real Earnings by Quintile*

As at June 2023, year-ended



* Inflation quintiles constructed by income levels.

** Total hourly rates of pay, excluding bonuses and commissions; quintiles constructed using hourly wage rates in the previous period.

*** Single Touch Payroll employment income per worker for those with a 2019/20 tax return; percentiles constructed using employment income in the current period; estimates are based on the percentile at the midpoint of each group; administrative data on incomes are not necessarily directly comparable to published aggregate estimates.

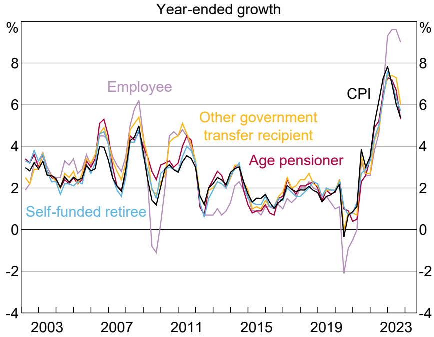
Sources: ABS; ATO; RBA.

more than other groups as they typically have the most constrained budgets, spend a greater proportion of their income on essential items and have lower financial buffers. Relative to a year ago, a greater share of people across the income distribution are identifying cost-of-living concerns as their most important issue (Graph 4.29).

Graph 4.28

Selected Living Cost Indexes by Household Type*

Year-ended growth



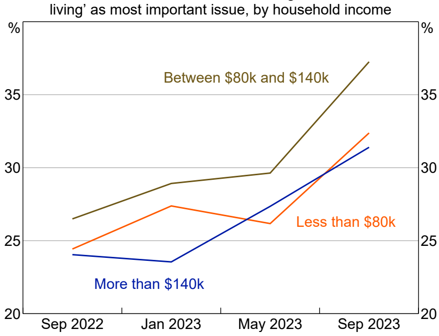
* The living cost indexes include mortgage interest payments (which are not included in the CPI) but exclude the construction costs of new dwellings (which are included in the CPI); other financial and insurance items also differ between the indexes.

Source: ABS.

Graph 4.29

Cost-of-living Concerns*

Share of individuals nominating 'cost of living' as most important issue, by household income



* Response to McKinnon Poll question on 'what are the most important issues facing Australia today and into the future that we should be doing something about?'; 'cost of living' is one of 20 possible response categories.

Source: McKinnon Poll, Susan McKinnon Foundation.